

## Internal Revenue Service

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### LEGEND:

Trust =

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

A =

B =

C =

D =

Dear \_\_\_\_\_ :

This responds to your letter dated July 28, 2010, and subsequent correspondence submitted on behalf of X, C, D, and Trust, requesting a ruling under § 1361(d) of the Internal Revenue Code (the Code).

### **Facts**

X incorporated on Date 1. A, a shareholder of X, died on Date 2. Pursuant to A's will, Trust become a shareholder in X. X made an S corporation election effective Date 3. B, the income beneficiary of Trust, made an election to treat Trust as a qualified subchapter S trust (QSST) effective Date 3. B died on Date 4.

Upon B's death, Trust's assets were divided into two shares. The income from one share is required to be paid to C and the income from the other share is required to be paid to D. During the life of each of C and D (the income beneficiaries), the income and principal from one beneficiary's share can only be paid to that income beneficiary. Neither income beneficiary has a claim against the income and principal of the other beneficiary's share. Since Date 4, the income from each share of Trust has been distributed to the income beneficiary of that share. Neither beneficiary has affirmatively refused to consent to the QSST election made for Trust on Date 3.

A ruling is requested that (1) each share qualifies as a separate share under § 663(c); (2) each share qualifies as a QSST within the meaning of § 1362(d)(3); and (3) C and D are successive income beneficiaries under section 1361(d)(2)(B)(ii) of the Code such that C and D are not required to file QSST elections for Trust's QSST election and X's S corporation status to continue.

### **Law and Analysis**

Section 1361(b)(1) of the Code provides that a small business corporation means a domestic corporation which is not an ineligible corporation for such year and which does not, among other limitations, have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) who is not an individual. Section 1361(b)(1)(B).

Section 1361(d)(1) of the Code provides that, in the case of a QSST with respect to which a beneficiary makes an election under section 1361(d)(2), such trust shall be treated as a trust described in section 1361(c)(2)(A)(i) and for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in the S corporation with respect to which the election under section 1361(d)(2) is made.

Section 1361(d)(2)(B)(ii) of the Code provides that if a QSST election is made with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

Section 1361(d)(3) of the Code defines a QSST as a trust all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States. In addition, the terms of the trust must require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary.

Section 1361(d)(3) of the Code further provides that a substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of section 1361(d) and (c).

Section 663(c) of the Code provides that for the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

Section 1.663(c)-1(a) of the Income Tax Regulations provides that if a single trust has more than one beneficiary, and if different beneficiaries have substantially separate and independent shares, their shares are treated as separate trusts for the sole purpose of determining the amount of distributable net income allocable to the respective beneficiaries under section 661 and 662 (the separate share rule). The regulations further provide, in section 1.663(c)-1(c), that the separate share rule may be applicable even though separate and independent accounts are not maintained and are not required to be maintained for each share on the books of account of the trust, and even though no physical segregation of assets is made or required. Section 1.663(c)-3(a) provides that the applicability of the separate share rule generally depends on whether trust distributions are to be made in substantially the same manner as if separate trusts had been created.

### **Conclusion**

Accordingly, based on the information submitted and the representations made, we conclude that the shares of Trust created upon the death of B are substantially separate and independent shares within the meaning of section 663(c) of the Code and, therefore, that each share is treated as a separate trust for purposes of section 1361(d).

We further conclude that provided that all the net income for each share is distributed currently to the applicable income beneficiary and each share is administered as a QSST, each share of Trust will qualify as a QSST under § 1361(d)(3) during the life of the income beneficiary for that share.

In addition, provided that Trust's QSST election is valid and not otherwise terminated, the income beneficiary of each share of Trust is a successive income beneficiary under section 1361(d)(2)(B)(ii) of the Code, and, therefore, is not required to file a QSST election with respect to his or her respective separate share for Trust's QSST election and X's S corporation election to continue.

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the transaction described above under any other provision of the Code. Specifically, we express or imply no opinion regarding whether X is otherwise eligible to be an S corporation or whether Trust and its separate shares are otherwise eligible to be QSSTs. Further, if Trust is divided into separate trusts, this ruling is null and void.

This ruling is directed only to the taxpayers that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being furnished to the authorized representatives for X, C, D and Trust.

Sincerely,

*Faith P. Colson*

Faith P. Colson  
Senior Counsel, Branch 1  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)